S&P Global
Market Intelligence

Netflix, Inc. NasdaqGS:NFLX

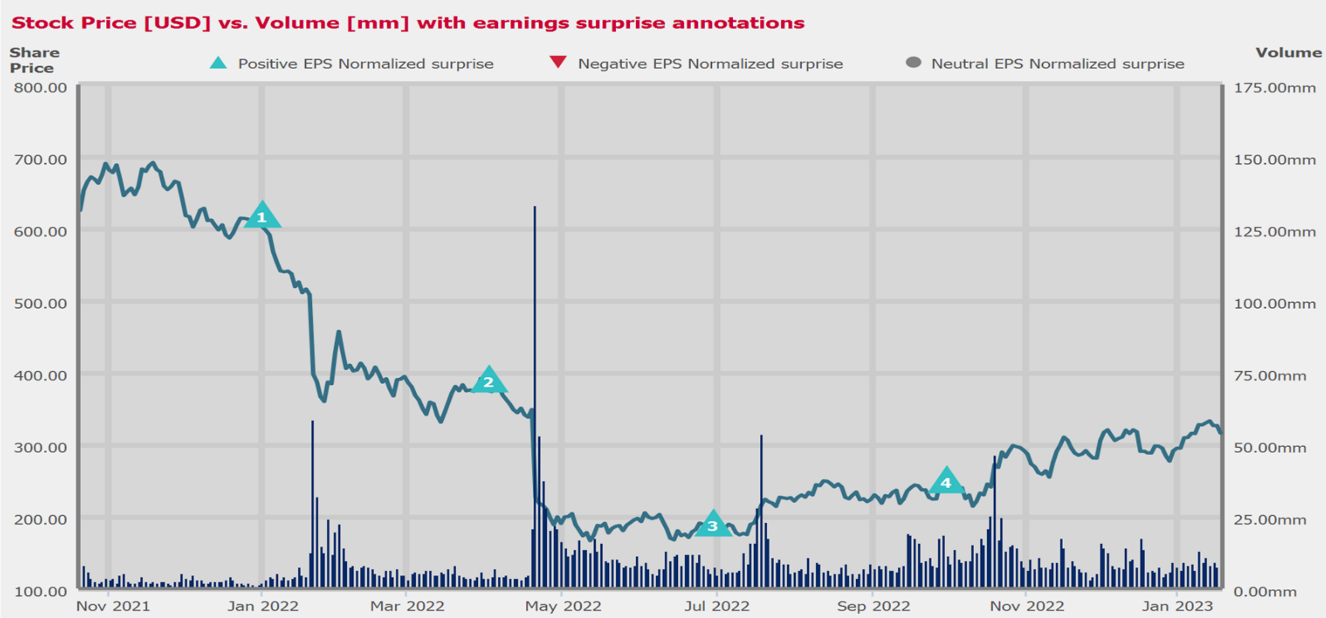
FQ4 2022 Earnings Call Transcripts

Thursday, January 19, 2023 11:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2022-				-FQ4 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	GUIDANCE	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.16	3.10	2.14	▲43.52	0.51	10.35	10.64
Revenue (mm)	7842.90	7925.59	7838.00	▲1.05	7855.81	31612.01	33951.26

Currency: USD
Consensus as of Jan-19-2023 10:01 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2021	0.82	1.33	▲62.20 %
FQ1 2022	2.92	3.53	▲20.89 %
FQ2 2022	2.94	3.20	▲8.84 %
FQ3 2022	2.16	3.10	▲43.52 %

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Call Participants

EXECUTIVES

Gregory K. Peters
COO & Chief Product Officer

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Spencer Adam Neumann
CFO & Principal Accounting Officer

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Wilmot Reed Hastings
Co-Founder, Chairman, President & Co-CEO

ANALYSTS

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Presentation

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Good afternoon, and welcome to the Netflix Q4 2022 Earnings Interview. I'm Spencer Wang, VP of Finance, IR and Corporate Development.

Joining me today are Executive Chairman, Reed Hastings; Co-CEOs Ted Sarandos and Greg Peters; and CFO, Spence Neumann. Our interviewer this quarter is Jessica Reif Ehrlich from Bank of America.

As a reminder, we'll be making forward-looking statements, and actual results may vary.
With that, Jessica, over to you for your first question.

Question and Answer

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Thank you, and thank you so much for having me today. So Reed, the big announcement about the management changes. Could you give us some more color on the process and how you came to this decision?

Wilmot Reed Hastings
Co-Founder, Chairman, President & Co-CEO

Jessica, it feels like yesterday was our IPO. We were covered in red envelopes. We IPO-ed at about $1. Hopefully, some of you have held the stock, the full 21 years. And when I think of the evolution, the three of us and so many other incredible Netflix employees to go from DVD service to streaming leader in films and television and emerging player in games. And now to have over 230 million members, it's just -- well, Jim Collins probably said it best. He calls it a good start. We've had a good start.

But honestly, we dream of the whole world finding their favorite entertainment Netflix, and we shorthand that as entertaining the world. And the three of us have been working together for 15 years now trying to figure out how do we get through this issue, that issue, how do we grow. And I couldn't be happier to complete our succession process.

It really started about 10 years ago with the Board trying to think through how could this work. They both have such amazing talents and gifts, and to find a platform where they've been able to contribute is fantastic. About 2.5 years ago, we took a partial step. Ted as Co-CEO, Greg as COO. We continue to just make super progress. And frankly, more and more, they've been leading the company, and this is acknowledging really in formal terms how we've been operating for at least the last few quarters. It's just a great feeling.

And when I think about the stock appreciation over the last decade, I know that they want to beat that record, and I'm all for that. I'll be Executive Chairman, helping them everywhere I can, but it's really theirs to lead and to do that energy and hustle and intensity that we've been doing. They're very ready. That's what's driving the timing, and so I could not be happier. So back over to you.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Thank you. Subjectively, I'll just add that this may be the smoothest transition we've seen in media for quite a while. Now for Ted and Greg, what does this mean for Netflix? Does this signal a change in strategy or approach?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Jessica, let me start with, first and foremost, to thank Reed personally and professionally. He has been, and I trust will, continue to be a role model, a mentor, a friend. And 22-plus years, he has positively changed my life in every way imaginable, and he leaves some big shoes for Greg and I to fill. Unfortunately, we have four feet to do it with. So that's a good thing.

In so many ways, the way that Reed has been able to see around corners. That's why he's been thinking about the succession for the last decade. He generously opened up more of a co-leadership model over a decade ago for he and I -- and like you said, 2.5 years ago made it a little more formal. And in that time, delegating a lot of the day-to-day to Greg and I. And in that time, in the 2.5 years we've been working at it. We've been working together for 15 years, Greg and I. But in the last 2.5 years, particularly, we've been able to build a really trusting, respectful and complementary partnership. In many ways, the same way I would read over the years. And I really do believe that this kind of shared leadership model is going to help us to move fast to challenge each other, to challenge the company to raise to new heights. And I'm just incredible what we're able to do.

And to your point, this is the leadership team. It's been pretty stable, and that's why that steady transition feels so steady. The ability of this team has helped us build a great foundation and a culture that can absorb complexity and change. And as you saw in this last quarter, it can rise to any occasion. And Greg, I just want to say I'm thrilled to be in this with you. And Reed, we can't thank you enough.

Gregory K. Peters
COO & Chief Product Officer

Thanks, Ted. It's a real honor to be asked to take on this responsibility and join you as co-CEO and frankly a pleasure to be able to compete to working with some of the most amazing leaders that I've ever had the pleasure of working with and frankly, in my opinion, the best leaders the Netflix has ever had.

So I'll just echo Ted's comments. It's been a real fun and rewarding experience to work closely with him over the last couple of years especially, and I'm tremendously proud of the partnership that we've developed in the shorthand and really how we have been able to take what are sort of a complementary set of skills and perspectives and seeing different angles to different situations.

But basically, at the end of the day, we are, I've always found, are ultimately motivated by the same thing, which is that we want to serve our members. And we want to grow our business, and that is an incredible powerful lining process to those different perspectives. So I'm proud of the work that we've done over '22 in the latter half, especially to get some more momentum into the business, but I'm even more excited about continuing to push that into '23 and follow the model that Reed has always had of continually seeking excellence and always striving to be better. So looking forward to that.

And then to your specific question, Jessica, we -- there's no big strategy shift or big culture shifts Ted, Reed and I have been working and sort of grinding through our individual on this for a long time. And so really, we look forward to taking things forward as we have been for the last little bit in responding to a dynamic industry and doing the changes that we think are appropriate. But we're not -- we don't have a bank of changes that were -- that we've been holding for this moment. So mostly, it's continuity and move forward.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Great. So this was originally for Reed. But now given the change in leadership structure, maybe for all three of you, for Reed, Ted and Greg. One of the best quotes recently was from John Malone, who said shareholders should build a monument for Reed hastings.

John Rupert Murdoch ran the dominant global media companies in prior decades, and we're one of the few media executives who've been able to see around corners. Ultimately, they both sold the bulk of their assets. Netflix is now one of the most dominant global media companies, if not the dominant. What is your view of the next 5-plus years? Do you need to get bigger? Stay the course?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Well, the one thing I'd point out is that what's happening now and what's going to be happening over the next couple of years is that the consumer is moving to streaming. So the way that they watch content at home delivered to them on Internet on demand, free of the linear schedule and all those things, that is a change, a fundamental shift in the business, and you've got to be where the consumer is. And that's what we've been focused on since we started streaming, doing original content 10 years ago, but being really realizing that we really have benefited from being a customer-first company and meeting the customers where they are.

And we've also had the blessing of that having to unwind our traditional media business as we built into this one. So we've always been focused on the future and where the consumers are going. And I think our ability to continue to stay focused on that because we're -- this is really -- I know we've been talking about it for a long time, Jessica, but this is really in its infancy. I mean you think about as big as we've become and all these things that are happening. And in the U.S., we're about 8% of TV time still. So it's an enormous amount of growth ahead, even in markets where we are very well-established. So that's the key for us, and I think being able to focus on consumers first. And it has really been our biggest benefit, and I think it's what led us to those milestones that you just referred to. Greg?

Gregory K. Peters
COO & Chief Product Officer

Yes. And Jessica, I would say I think that, that translates into being bigger. And I think that means being bigger in terms of touching more members around the world, delivering them entertainment. We'll see that in terms of being bigger, in terms of the amount of engagement that we can drive, the amount of hours that we're satisfying them. That would be bigger in terms of the culture impact is too. I mean you've seen -- I mean just incredible cultural impact in terms of Wednesday, Stranger Things. The ramifications that these shows have in terms of the popular culture are significant, and that's going to get bigger, too. It also means bigger in terms of revenue and profit streams. So we're looking forward to those as well.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Right. So losing subs in 2022 and the market reaction or valuation reset is akin to August 2015 when Bob Iger called out the early decline of subs and the impact for Disney's ESPN. It will take a while for Disney to build ESPN Plus into a sports streaming giant. And actually, they may never replace the profitability of ESPN at that point in time. Your pivot seems more broad-based by extending genres and going into new areas, whether it's games, fitness, live, et cetera. Do you see any similarities or differences to that momentous inflection point, which has certainly shifted Wall Street's view from subs to profits?

Gregory K. Peters
COO & Chief Product Officer

I'll take a shot at that. And then Ted, maybe weigh in. But I think it's a fundamentally different situation. And if you look at where we're at, a significant part of what we need to go do is essentially take the core model that we've been operating since we've been starting in streaming and just execute it better in all dimensions.

And so whether it's the incredible content that Bella and Scott's team are producing constantly, how we're talking about that content to the marketing and conversation that we do, the product experiences and business model innovations that we're doing. But a lot of it really fundamentally is about executing that core model better.

We're not -- there's not a lot of massive pivots away from a traditional legacy business model that we have to go figure out. We're planting some seeds in terms of games and things like that, that if we execute well and we're excited about the progress we're seeing so far, will represent the future potential for us in terms of and more profit opportunities. So that's exciting. But essentially, a lot of this is just continue to execute the play that we've got and do it better and better.

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

And I don't know about what the similarities, but I would say that this business is really completely about engagement, profit and revenue. So -- and we've got to grow all of those things, and all those things are really are tied to executing on that -- on the content. When the content is working, the business is working. We grow engagement, we grow revenue, we grow profit.

There's an interesting thing starting in July and you think about from Stranger Things Season 4 from the phenomena that it became and what we've been able to offer up to our members from that day forward. So they went from Stranger Things to Extraordinary Attorney Woo, which was a phenomenal success throughout Asia and South Korea, but also built a big cult fan-base in the U.S., straight into Sea

Beast, which is our biggest animated film ever; straight into Purple Hearts and Gray Man, two of our most watched films ever on Netflix. And then to August, the Sandman and Never Have I Ever Season 3. September, Copra Kai Season 5. Empress, Cyberpunk is this animated adaptation of a video game that's been hailed as one of the greatest of all time.

Narcos, saved another monster hit from North Korea. The Jeffrey Dahmer story, Monster, straight into watchers, go back-to-back hi ts from Ryan Murphy. All Quiet on the Western Front, which just today became the most nominated non-English film in the history of BAFTAs. Only Gandhi has got more nominations in the history of BAFTAs, and that's from Germany with the great Ed Burger. And then straight out of that into Enola Holmes 2, a big monster success, sequel to -- with Millie Bobby Brown.

And you look at all of these things that go back and forth, and they go all the way into January now, we'll end the month with you people, Eddie Murphy and Jonah Hill. Any outlet would kill to have any one of those months as their entire year. And it's our ability to fire on those owners and create hits, but more than that create the expectation that as soon as you're done with this one, there's another one waiting for you.

Spencer Adam Neumann
CFO & Principal Accounting Officer

Jessica, just one thing to add. I know but I just think the analogy is kind of fundamentally different. With ESPN and the example you gave, that was a fundamental kind of shift in the industry from 100-plus million pay TV connected homes to cord cutting that's on a path down to mid- to high single-digit reductions in that distribution platform each year, and that's moving in that direction. So it's kind of a shrinking core distribution platform, where when you see in our earnings letter, the world is shifting from linear to streaming.

Even in the largest -- there is no country where streaming is more than 40% of share of TV time. And in many big countries, as you saw, it's less than 5%. So it's our 5% -- or less than 5%, it's less than 10%. So there's an incredible runway still in the shift from linear to streaming. And so for us, it's about growing into that shift and also obviously competing well and continuously innovating and improving.

And what you saw or what we saw and felt when we had that decline in subscribers was really near-term limiters in growing into that big market. But the big market is still growing as opposed to fundamentally long-term limiters in that ESPN shift that you described.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Right. So let's move on to some of the drivers of growth, both near and medium term and start with advertising. So your advertising platform has been open only months, and you've amazingly given some money back to advertisers indicating in one way that demand is exceeding supply. The company is, you guys have consistently said you're going to crawl, walk and run. How is the process going relative to your expectations?

Gregory K. Peters
COO & Chief Product Officer

Yes. Like you say, it's 2 months. And I think the hardest part is actually that first step when you're crawling because you don't really know what exactly to expect as you get it going. And now with 2 months, we're ridiculously early, but we've learned a bunch already, I would say.

So just ticking through this, I mean, I'd say, first and foremost is that we were able to launch this very, very quickly. And the tech is all working. The product experience is good, and that's really a testament to lots of hard work for both Microsoft and Netflix teams who worked very hard to make that happen, and it's really rewarding to that to see.

The other, I'd say, pretty significantly fundamental thing is around engagement, and we see that engagement from ads plans users is comparable to sort of similar users on our non-ads plan. So that's really a promising indication. It means we're delivering a solid experience and it's better than we modeled, and that's a great sort of fundamental starting point for us to work with.

Furthermore, now, we're seeing take rate and growth on that ads plan is solid. It's great because partly, that take rate and that growth is due to incremental subscribers coming into the service because we have a lower price point. That's $699 in the U.S., EUR 499 in Germany, just to give you two examples. And so that elasticity is a real -- not only a benefit to sort of growing our ad scale and sustainability, but the general business. I expect to see that continue to actually grow over the year.

That take rate fits sort of within the middle of our other plans, which is another really healthy sign. It means that we've got a complementary set of offerings that are working to sort of satisfy different needs for different consumers at the right mix of features and price points. So that's quite good.

Another important one, I think, for the investor community because it came up a lot before we launched was plan switching. We aren't seeing as expected much switching from high arm subscription plans like premium into our ads plan. So the unit economy remain very good as we modeled. So these are all really good initial sort of progress points, but I think it's important to reiterate that. As you mentioned, we're crawling and we'd like to get to sort of move to the walking phase. We've got a lot to do to get there.

So there's a bunch of technical improvements terms of ad delivery validation, measurement. We've got progress already on that. More to do in the next quarter or 2. Targeting improvements, which will be better for consumers. More relevant advertising, better for advertisers in terms of more value delivered, a better set of offerings on products for advertisers to buy. We've got a long list of experience improvements that we know we can deliver that will live more value to both subscribers and advertisers.

And there's just also some nuts and bolts stuff that we are learning and improving, just things like how do we do a better job with Microsoft at the ad sales and operations processes. There's so much that we need to do both companies need to better serve advertisers sort of an increasing number of advertisers and meet that demand. So we're just getting started. We're constantly improving, and we see the trajectory ahead of us. And really, our aspirations are ultimately successively over a period of years to basically build, just like we have essentially in terms of the streaming experience, the best, most effective, highest quality premium connected TV ads experience as a win for consumers and advertisers and for us as a business.

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Spence and Greg. Sorry, Jessica. Spence, maybe give a little context on Hulu, kind of what we know about Hulu's advertising. They've got a 10-year head start. And sort of how many years will it take us to sort of pass them in all of these key dynamics?

Spencer Adam Neumann
CFO & Principal Accounting Officer

Greg, do you want to go first or you want me?

Gregory K. Peters
COO & Chief Product Officer

No, I'll hand it over to you.

Spencer Adam Neumann
CFO & Principal Accounting Officer

All right. Let's see. I mean Hulu is -- yes, they've had a long head start, they started in the ads business. They have -- we would estimate, reason we obviously don't know exactly, but roughly half of their membership is on the ads tier. It's a multibillion dollar business for them already, and that's a domestic business, U.S. only. So lower reach, lower engagement than us.

So I guess the short story there is we have given what we've seen and what Greg just outlined in terms of the engagement on our ad plan, the strength of the performance in terms of the monetization, kind of the unit economics and our ability to kind of scale in a way that is even better than the kind of comparable ad free plan, plus providing clearly choice that our members or consumers are seeking out because of the sign-up flow that we would expect to be as large or larger over time, certainly in just our U.S. market and more from there.

But it's -- I just want to emphasize, it's a multiyear path. So we're not going to be larger than Hulu in year 1. But hopefully, over the next several years, we can be at least as large, and we wouldn't be getting into this business obviously, Reed, as you know, if it couldn't be a meaningful portion of our business. So we're over $30 billion of revenue, almost $32 billion of revenue. in 2022. And we wouldn't get into a business like this if we didn't believe it could be bigger than at least 10% of our revenue and hopefully much more over time in that mix as we grow. So that's kind of how I see it without putting a specific guide on it.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

You committed to an upfront market spot, taking CBS's prior spot,CBS Now Power mount spot, which really indicates your long-term advertising goals of being a major advertising platform. Given this is a prime spot on a critical week for advertisers in premium video. Like it's just -- it's amazing how quickly you just took that lot away. What's the run stage? And how would you and what's the time frame to get there?

Gregory K. Peters
COO & Chief Product Officer

Well, I think as Spence talked about it, it will be an iterative process. To your point, it does signal that we have big aspirations here, and we think there's a big potential opportunity, and so we're committed to incrementally execute against that opportunity.

But just back to Spence's point, we are starting from a 0 base essentially. And also, we're also starting from a history where as a non-ads platform, we had a lot of folks to basically join Netflix fully as non-ad subscribers, and so I think that we'll be working through that over a period of time. But again, our goal and aspiration is that this is a very meaningful and significant source of revenue and profit for us over many years to come.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

So I mean when you think about the pool of money that you're targeting, linear, let's call it, $50 billion, $60 billion business, seems like the easy money, you've mentioned already. These are shifting from streaming to streaming from linear, so we've seen all of the kind of eyeballs move. And so now you have basically more scale or reach, but the digital pool is much larger. But in the past, you've said you've made comments, the company's made comments that you can't compete with Google and Meta or it would be incredibly difficult to compete with them. Has this changed? Has your view changed?

Gregory K. Peters
COO & Chief Product Officer

Not really. I would say that initially, we're competing mostly with that sort of traditional TV advertising pool. Now I think we can layer into that over time, components of what has made digital advertising so effective. So if you think about the targeting capability, the fact that we signed in fully addressable. If you think about the growing relevance of first-party data and how we do that, those are real big advantages that we can bring relative certainly to the traditional world.

But again, the form that we have at least for the next couple of years will still be in that sort of lean back -- primarily in that lean back experience. And so that lends itself to certain kinds of advertising and certain kind of advertising goal. And a lot of the demand collection component that a Google or a Facebook is really good at. We won't be well-suited to compete with that for at least some time to come.

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

And Jessica, just to add to that. The good news, as you saw in the letter, is that, that branded video ad market that Greg talked about us focusing on is about $180 billion, globally ex China and Russia. So we have plenty to do and a lot of opportunity ahead just in that area alone.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Yes. No, it's an enormous opportunity, but there's also, besides advertising, there's enormous opportunity in incremental subscribers, as you have mentioned. You are the lowest priced service, at least now you are the lowest price, but can you frame the opportunity in terms of sub growth and how you're thinking about it?

Gregory K. Peters
COO & Chief Product Officer

Sure. And just to comment on lowest price. I mean, again, we don't really think about the pricing question from it perspective. Again, we're -- think of ourselves as a nonsubstitutable good when you think about Wednesday or you think about Glass Onion, these are titles you can only see on Netflix that's extremely powerful. Scott and Bella are delivering more incredible titles that are nonsubstitutable in that regard.

So really, when you think about the pricing question is how do we offer a wide range of options for a wide range of consumers. We want to make that spectrum even wider as we seek to serve more members around the world and trying to deliver appropriate value at those different price points, and we're doing a good job expanding that range.

And so then you think about so there's sort of two pools of incremental subscribers. There's a bunch of people around the world in countries where we're not deeply penetrated, and we have more opportunity to go attract them. A component of that is we've got folks that are watching Netflix who aren't paying us as part of basically borrowing somebody else's credentials. And our goal is over this year to basically work through that situation and convert many of those folks to be paid accounts or to have the account owner pay for them to get enough subscription. But either way, we're seeking to sort of monetize the viewing value that we're delivering.

And then beyond that, it's back to Spence's comment, even our most penetrated market we're 8% of total TV time, which is potentially a relatively narrow length to think about the broad competitive entertainment offering. So we have huge opportunity to grow the engagement component of that several X. We feel like we can get to if we do a great job of executing across all fronts, and that represents a tremendous opportunity for more entertainment value delivered, and we believe that the revenue flows from that in time.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Before we get to password sharing, just one last advertising question. You now have roughly a decade of producing your own IP. Any thoughts on offering a fast service over time, readvertising supported television?

Gregory K. Peters
COO & Chief Product Officer

Ted, do you want to take this one?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Yes. Look, we're open to all these different models that are out there right now, but we've got a lot on our plate this year, both with the paid sharing and with our launch of advertising and continuing to this slate of content that we're trying to drive to our members. So we are keeping an eye on that segment for sure.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

So on the password sharing, what will drive consumers to pay $3 or $4 per sharing versus becoming a sub with their own profile? Is it affordability? Is there something else? What do you expect?

Gregory K. Peters
COO & Chief Product Officer

Yes. I think there's a range of motivations for different borrowers. So some of it is economically driven and so a part of what we're trying to do is that we are being responsive to that and finding the right price points, whether in terms of an individual account or an extra member affordance. And obviously, the ad-supported plans give us the opportunity present a lower consumer face pricing in those countries where we have advertising.

Part of it is just what we call casual sharing, which is people could pay, but they don't need to, and so they're borrowing somebody's account. And so our job is to give them a little bit of a nudge and to create features that make transitioning to their own account easy and simple. So we have this basically a profile export feature, which allows you to take your viewing history and all the great recommendations with you. So to your point, there's a range of motivations and I think a range of solutions that we'll be able to offer to land people in different places.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Can you provide any details, including the time frame for converting borrowers to paying accounts?

Gregory K. Peters
COO & Chief Product Officer

Yes. So we've been working hard at this and trying to do some sort of thoughtful experimentation to let our members speak to us in terms of what set of solutions work for them. So that's the testing that you've seen us do over the last couple of quarters.

We feel like we have gotten to a good set of features. It's the profile export that I mentioned, but there's also a bunch of account management features that we think are important to making this experience work for folks. And so we're ready to roll those out later this quarter. We'll stagger that a bit as we sort of work sets of countries, but we'll really see that happen over the next couple of quarters.

And I think it's worth noting that this will not be a universally popular move, so there will current members that are unhappy with this move. We'll see a bit of a cancel reaction to that. We think of this as similar to what we see when we raise prices. So we get some increased churn associated with that for a period of time. But then generally, what happens is both from the specific changes that we make, we'll see folks come on as new subscribers, essentially borrowers creating their accounts or incremental monetization through the extra member that will happen shortly thereafter.

And then clearly, our job is to continue to grow value, right, to have more amazing titles that people cannot wait to see and whether that's satisfying those members to make those transitions or winning back essentially folks who have turned off the service and bringing them back on the service over the months and years to come.

Spencer Adam Neumann
CFO & Principal Accounting Officer

Jessica, sorry, I just -- maybe just because we touched on it a little bit in the letter, but just to kind of reinforce a little bit of what that looks like in terms of timing and guidance. So those dynamics that Greg just walked through, because of that as we kind of start to roll this out later in Q1, based on the timing, what we talked about is that we'll have modest growth we expect in paid net adds in Q1, but kind of atypical seasonality, where typically Q2 would be a softer paid net add quarter. It will probably be a larger paid net add quarter. And most importantly, what we're most focused on is obviously revenue. That is our primary metric.

And what you see is in the guide, these revenue initiatives between paid sharing rolling out and then scaling ads, you don't see much of that in Q1, which is why we're forecasting 80% growth, FX neutral in Q1 revenue. But throughout the course of the year, we would expect to see accelerating revenue growth as we roll out paid sharing broadly across our business and then obviously, scale adds throughout the year, which is a more gradual build. So I just want to kind of highlight that, and that's kind of what you're seeing in the guidance.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

And given the revenue drivers of paid sharing and advertising, how are you thinking about price increases in the current year? Is it just too complicated? How are you thinking about it?

Gregory K. Peters
COO & Chief Product Officer

Well, I would say the two initiatives that you described represent the bulk of our pricing strategy in '23. We anticipate that they'll both be revenue positive, revenue accretive significantly. So in the -- according to the details that Spence just offered.

Now having said that, our core sort of pricing approach in theory remains the same, and so we're going to look at the metrics that our members are giving us and telling us and look for opportunities where we've -- I think we've done a good job of creating more value for them and for a certain customer segment and a certain tier and a certain country, we think we've done a good job at delivering more entertainment for them. And then we'll go back and opportunistically ask for them to pay a little bit more so that keep this virtuous cycle going and really invest that back into incredible content and stories. And maybe, Ted, I don't know if you want to highlight anything you see comment on that side.

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

No, I would just say that it's the must-seeness of the content that will make the paid sharing initiative work. It's -- that will make the advertising launch work that will make continuing to grow revenue work. And so it's across film, across television. It's the content that people must see and then it's on Netflix gives us the ability to do that. And we're super proud of the team and their ability to keep delivering on that month in and month out and quarter in and quarter out and continuing to grow in all these different market segments that our consumers really care about. So that, to me, is core to all these initiatives working, and we've got the wind at our back on that right now.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

But you amazingly continue to expand the genres of content, which, as you guys have mentioned, clearly drives engagement. But the most recent new genre, which you introduced on your platform in -- at the end of last -- very end of last month is fitness.

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Just in time for your New Year's resolution, yes.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

One class online could be the price of a Netflix subscription. So while many of the work at our bite size. I mean some along, they're simple, but deceivingly effective. Can you talk about what your plans are in this area? And as you develop more content, it really, as I said, drives value for anyone who would work out anywhere else. So how do you define success? And is there anything you could take about partner economics with Nike?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Yes. We can't comment on the partner economics, but I would tell you that we've historically stayed away from the fitness category because it's abundantly available online. In many cases, for free, as you know. But we thought if we could partner with a great brand, and Nike is certainly a leading brand in fitness with really well-produced content, which this content is, and then let's go out to our members and see if it's something that they value. And we'll see that in the engagement and see where we could take it from there.

So I think in that way, working with a great partner and the high quality, to your point, of the content itself, will put it in a really good test, do people want to use Netflix to get in shape or to get back in shape. And if they do, we'd like to keep serving that. And if they don't, we'll keep poking around. So it's the way we kind of -- we're able to test the market at a very high end with a premium brand partner.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

There's constant speculation that you will experiment with sports, which is an expensive rental business for many. Does having an advertising offering change your views on offering sports? And any thoughts that you -- on like WWE, which is for sale, that could be -- potentially, I just think that could be owned content like any views on sports.

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Yes. Look, I'd say in sports, our position has been the same, which is we really -- we're not anti-sports for pro profits, and we've not been able to figure out how to deliver profits in renting big league sports in our subscription model. Not to say that, that won't change. We'll be open to it, but that's where it's at today. And in WWE, we look at -- we have a lot of M&A activity all the time. We look at all of them, but nothing we can comment on.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Does this term play a roll in your investments into live events? Live comedy specials seems to have a value outside of the live window. Other events, like you just announced that you're going to host the SAG Awards. Sports, obviously. These have fairly short lives. So how do you balance the investment in live versus the potential to drive advertising dollars?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

I would look at this as part of just like other crawl/walk/run scenarios, where we are really looking at our content that would benefit creatively for being live. So the results show for one of our competition series that we have or a reunion show that drives news or like the SAG Awards and opportunity to engage audiences live. And because we've got the shelf space, we can do hours of shoulder programming around the live events and all of those things that our members may enjoy. So think -- there's nothing particularly novel about live television, as you know. But we are dabbling in it, starting with our Chris Rock Live concert to try to create the excitement around live for those things that are uniquely more exciting to be live.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

The theatrical release of Glass Onion was incredibly successful in its limited release. But -- so for some , it looks like you left a lot of money on the table by not continuing beyond the first one week. Do you have any regrets? Or can you give us your thoughts on your evolving film strategy?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Well, I'm thrilled with every aspect of the release of Glass Onion, starting with Ryan Johnson, and he's a great film -- and Scott Stuber and the film team for bringing it to the table. And I think what you saw was a lot of excitement. We drove a ton of us with that theatrical release, and we created a bunch of demand. And that demand, we fulfilled on our subscription service. So our core business is making movies for our members to watch on Netflix, and that's where we're really focused, and everything else is really a tactic to drive excitement around those films.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

So look like a massive global hit like a Wednesday. There seems to be so many ways you could drive monetization. I know like just staying with margin for a second. Like the Wednesday makeup was sold down in every Max Store in New York City. You could not buy it anywhere. Do you participate in these types of consumer products? Or is it just a way to fuel balance, fuel engagement?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

It's a little -- mostly the fuel engagement and fuel fandom. We actually -- we do participate in it. Our owned content, we do drive a lot of revenue in our consumer products business. But mostly, the motivation is that is to drive fandom. And Greg alluded to this earlier, but this impact on the culture that this content can have on our platform. In our earnings letter, we mentioned the Lady Gaga song came back after 11 years because of Wednesday. But that doesn't mention, the 4 songs this year that we actually jammed back into the charts, some that never charted and some that were off the charts for 40 years from Metallica, Kate Bush, The Cramps. And that impact on culture, Sofia Carson's music career took off because of Purple Hearts. Jenna Ortega picked up 10 million social media followers in the first week Wednesday launched on Netflix.

And all of these folks who built these gigantic careers on Netflix then go on to have to own their own companies, sell their own makeup in many cases and become incredibly powerful influencers. And all that business is drawn because of our -- the impact that this distribution platform, and its incredible UI that basically can take something like Wednesday, which was not a slam dunk for people to predict that people would love it as much as they do. And the UI could pick up on that activity in the early going of the release and push it out to where it's going to be one of our most watched shows in our history all over the world. And we do use consumer products as a way to intensify fandom. And it could be anything from makeup from Wednesday, as you said. Or maybe even a hand on your shoulder, Spence?

Spencer Adam Neumann
CFO & Principal Accounting Officer

Yes. You never know where Wednesday is going to show up or at least thing. I did get my chance to kind of talk and -- and at the risk of going back to the management changes and say, I am thrilled with the changes. I'm going to miss maybe not seeing Reed as frequently as he's supporting Greg and Ted. So I just brought in a little bit of reinforcement with thing even though Reed is not going anywhere. But this way, I've got a little daily reinforcement.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

Sticking with content for a few minutes. The local language hits a building, but so as the U.S. hits. How do you think about allocating your $17 billion or so content budget between genres or languages? Like is there any way like you can kind of parse it out?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Yes. It's a big task. Watching where viewing is growing and where it's suffering and where we are under programming and over programming around the world is a big task of the job. Spence and his team support Bella and her team in making those allocations, figuring out between film and television, between local language and what is -- and what's really interesting is there aren't that many global hits, meaning that everyone in the world watches the same thing. Squid Game was very rare in that way. And Wednesday looks like one of those too, very rare in that way. There are countries like Japan, as an example, or even Mexico that have a real preference for local content, even when we have our big local hits.

And every once in a while, something like Squid Game is even a big hit in the U.S. So think about in Q4, we launched a top 10 non-English series nearly every week of the quarter from South Korea, from Spain, from Colombia, from Japan, from Poland. And so the benefit of that kind of local language investment and the benefit of doing that early was that we become exceptional on the ground in those countries. Those content teams generate not just content people want to see, but content that's leading the industry.

To have Netflix produce the Academy Award entry film for both Mexico and Germany has never happened in the history of the Oscars. It's really phenomenal. And I mentioned earlier the All Quiet on the Western front and the success of BAFTA. And keep in mind that these investments are important because it actually increases the total addressable audience for Netflix around the world. Because if we were just doing English content for the world, we would be mostly attracting Western-centric viewers, but our addressable audience is anyone who's watching TV anywhere in the world.

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Jessica, we have time for one or two last questions. I just want to make sure you have a chance to ask about margins or anything else you might want to.

Jessica Jean Reif Ehrlich Cohen
BofA Securities, Research Division

So let's move away from content then. So free cash flow. First of all, like, what an inflection point, $1.6 billion 2, roughly $3 billion in '23, $4 billion plus probably in '24. Can you just talk about -- historically, you've been more build than buy. Is there any change in philosophy as cash starts accelerating? Can you talk about overall capital priorities? And what's driving that operating margin increase?

Spencer Adam Neumann
CFO & Principal Accounting Officer

Spencer, why don't you go first with the capital allocation philosophy, if you like.

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Sure. Thanks, Jessica. So as we wrote in the letter, no change at all to our capital structure policy or allocation guidance, which is to, first and foremost, reinvest in the core business and selective acquisitions after that. Those are the main priorities. Beyond that, if we have cash in excess of our minimum cash levels, which we -- which is roughly equates to 2 months of revenue, then we'll return that to shareholders or share program.

Spencer Adam Neumann
CFO & Principal Accounting Officer

Yes. And I can pick up with margins, I can start with. It's a bit of an explanation. But if you like, in terms of just in the near-ish term, our outlook for '23 and then just generally, what's driving our outlook. But what you saw in the letter, it kind of dates back, frankly.

If we walk back to where we were in the beginning of 2022, when we saw a slowing revenue growth, we said, "We're going to manage to operating margin of 19% to 20% FX neutral at those January 2022 rates." And we ended the year at 20%, so at the high end of that range. And now as we kind of turn the page to '23, first, I should say, with everything we talked about, we've got -- we're quite optimistic in terms of our path forward.

I also just want to highlight there is also kind of short-term unusual amount of less visibility than typical because the things we're talking about in terms of our revenue initiatives, whether it's scaling our ad platform, launching paid sharing, which globally rolled out yet, these things are early days. And then also all multinationals have a level of macro uncertainty. So that's a bit of a caveat in terms of the variability in the forecast.

But what we see is we see with the -- our path to accelerating revenue growth and our high confidence there that as we turn forward to '23, we're guiding to now 21% to 22% FX-neutral operating margins at those same January 2022 rates. We're now in a new year, so we take it forward to January '23 to current rates, and that's a range of our operating margin guidance of 18% to 20%.

So now FX neutral for '23, we're going to manage within that band to deliver at least within 18% to 20% operating margin guide. So that is growing margins, growing absolute profit. And really what's reflected in there is that this -- we have high confidence in our ability to accelerate revenue throughout the course of the year as we scale ads and we launch paid sharing. We've got high confidence in improving the service and the strength of our content slate with everything that Ted discussed here on the call, and we're also continuing to manage our cost structure with increasing discipline. You saw that in the back half with our slowing expense growth, and we'll carry that through similarly in '23.

So that all lends itself to our focus, which is kind of healthy growing double-digit revenue growth and accelerating that revenue growth throughout the year, expanding our -- both our absolute profit and profit margin and then growing positive free cash flow. So that's all reflected again with the big caveat that there's a bit less visibility than typical in this near term. That's something we'll continue to work through. We'll obviously know a lot more over the next couple of quarters, a few quarters as we roll out paid sharing, and we'll update guidance as appropriate. But that's what plays through and then also plays through cash flow generation that you see, where we believe with all those dynamics and managing at about the same level of cash content spend that we'll have more than $3 billion, at least $3 billion of free cash flow in the year.

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Thank you, Spence, for that answer and, Jessica, for the last question on all your questions. And before I turn it over to Reed for closing remarks, I just want to say as a longtime Netflix employee, as formerly prior to that as an analyst covering Netflix for many years, Reed, it has been a real privilege to work alongside you. And on behalf of all Netflix employees, we thank you for everything you've done for us and the company over the past 25 years, and we're all super excited for the next chapter with you as our executive and Ted and Greg as our co-CEOs.

So with that, over to you, Reed, to make some...

Spencer Adam Neumann
CFO & Principal Accounting Officer

It's Spencer. I just -- because I can't just deal with this thing. I just want to thank Reed as well. This is not a goodbye, I know. But it's been fantastic. I couldn't have asked for a more incredible experience in the past 4 years with you as our leader, learned so much. across everything from work to humanity. And I'm so thrilled with the next chapter with Greg and Ted and you and so super excited. And thanks, Reed.

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Reed, you might be muted.

Wilmot Reed Hastings
Co-Founder, Chairman, President & Co-CEO

Thanks, you guys. It's certainly not goodbye. I'm heavily invested in Netflix' success. So there's been 83 earnings calls now, and I honestly have loved them. I love the interaction. But it's time for Greg and Ted and the team to lead, and I'll be in the prep sessions, but this will be my last earnings call on screen. Overall, I would say our first 25 years were good, and I'm super excited about Netflix's next 25 years being great under our broadened leadership team. Pleasing our shareholders and members is so satisfying, and I just want to thank all of you for your support and look forward to continued more progress. Thank you, everyone.